

capacity. Within range is a system capable of supporting hundreds of analog and digital channels for two-way services, multimedia communications, infrastructure support for personal communications services ("PCS"), and other services we are only beginning to contemplate.

Consumers of regulated cable services also will benefit from higher quality reception due to the use of fiber optic lines.³⁴ Similarly, the reduced number of amplifiers and the introduction of uninterruptible system power will result in more reliable regulated services on an upgraded system. Upgrades also will translate into accelerated compliance with the Cable Act's tier buy through requirement³⁵ and will enable cable systems to offer more regulated channels.³⁶ Furthermore, it is well recognized that consumers who rarely or never use a service nevertheless benefit from its general availability. Even those who do not necessarily subscribe to new services that become available on an upgraded system benefit from the option to purchase those services whenever they wish.³⁷ Finally, it is well established

³⁴ The use of signal regeneration rather than amplification results in improved signal quality.

³⁵ 47 U.S.C. § 543(b)(8).

³⁶ At least some of this will be brought about as a matter of law. For example, the obligation to provide leased access and must carry channels is tied to the capacity of the system.

³⁷ See Burton A. Weisbrod, Q. Jour. Econ. (August 1964) LXXVIII, 471-477; Alfred E. Kahn, The Economics of Regulation: Principles and Institutions, Vol. 2 (1971), at 236-241.

that the more people that use a network, the more valuable the network becomes.³⁸

Thus, the limited, episodic penetration of upgraded cable networks limits their overall value to the country's information infrastructure. By contrast, a regulatory environment which promotes efficient deployment of cable upgrades throughout the country increases their value to programmers and consumers.

The cost per subscriber of the addition of the fiber optics necessary for such an undertaking, however, cannot be recovered under the current benchmark/going-forward price ceilings. Nor do cost-of-service cases, which are piecemeal, costly, and uncertain, allow operators to devise coherent plans for a national upgrade. Alternative regulations are thus required to eliminate the regulatory impediments that distort the ability of cable operators to build the digital NII.

The Commission recognized this fact in February 1994 when it adopted a streamlined cost-of-service showing for substantial system upgrades.³⁹ As the Commission explained, "There may be

³⁸ See Michael L. Katz and Carl Shapiro, "Network Externalities, Competition, and Compatibility," 75 American Economic Review 424, 424 (1985) ("the utility that a given user derives from a good depends on the number of other users who are in the same 'network' as is he or she").

³⁹ See Cost of Service Order, 9 F.C.C.R. 4527, ¶¶ 285-291 (1994) ("We conclude that an abbreviated cost-of-service showing for network upgrades, with safeguards, provides an appropriate way to implement the goals of the Cable Act of 1992, to promote the availability of diverse cable services and facilities, encourage economically justified upgrades, and reduce regulatory burdens, while ensuring reasonable rates for regulated services").

cases where the benchmark rates do not provide sufficient revenue to attract capital for upgrades because of unusual costs associated with capital improvements."⁴⁰ The Commission accordingly decided to make abbreviated cost-of-service showings available for "significant upgrades requiring added capital investment such as expansion of bandwidth capacity and conversion to fiber optics, and for system rebuilds."⁴¹ The Commission specified that the cost of such upgrades would be recovered by charging a "capital improvement add-on" to the prices set under the benchmark rules over the life of the system.⁴²

TCI is encouraged by reports that the Commission is actively working on the release of the upgrade incentive form.⁴³ As the Commission knows, however, it is the details that will determine the form's effectiveness in creating the desired incentives.

Most importantly, the form should provide certainty, clarity, and simplicity in order to ensure that it promotes infrastructure improvements. In this regard, the form should provide the following:

- A self-executing approval method. The Commission should adopt a truly streamlined process that

⁴⁰ Id. at ¶ 286.

⁴¹ Id. at ¶ 287.

⁴² Id. at ¶ 290.

⁴³ See "Won't Come Again:" Cable Bureau To Resolve Rate Case Backlog By Memorial Day, April 28, 1995, at 4 (streamlined cost-of-service rules among Cable Bureau priorities for the summer). See also VDT Still Alive, Television Digest, May 15, 1995, at 6 (commissioners support "quick action on streamlined rate increase procedures for system upgrades").

permits a cable operator to file the forms certifying compliance with the requirements for the upgrade incentive and then add the appropriate amount to subscribers' bills. Any allegations that the cable operator improperly filled out the form or did not fully comply with the requirements for the upgrade incentive can be dealt with through the complaint and refund process. A self-executing form will avoid the need to create a complicated new review process that will waste Commission resources and delay system upgrades.

- A specified method for allocating common costs between regulated and unregulated services. An ad hoc, system-by-system approach to cost allocations will force cable operators, in effect, to negotiate a separate allocation scheme for each upgrade. This will create significant costs and delays that will undermine the goal of fostering rapid nationwide NII deployment. The "relative use" cost allocation standard in Part 64 of the Commission's rules⁴⁴ provides an established and tested methodology for allocating costs among regulated and unregulated services. The Commission should apply that methodology in this context.⁴⁵
- Jurisdiction over the incentive upgrade form should reside solely with the Commission. The underlying premise of the upgrade incentive is to facilitate rapid, nationwide deployment of the NII. As the Commission has recognized, in order to accomplish this goal, the process must be a streamlined one. It would be entirely self-defeating to require local approval as a pre-condition of taking the rate increase permitted by the upgrade incentive form.⁴⁶ Such a requirement would embroil cable operators in protracted local disputes that would recreate the uncertainty that has

⁴⁴ See 47 C.F.R. § 64.901(b)(4).

⁴⁵ The Bureau would have to devise a method for establishing relative use in the video context. Whether it decides to base usage on minutes of use, use of spectrum, or some other factor is less important to TCI per se than that the chosen methodology results in a reasonable allocation of the upgrade costs to both regulated and unregulated services.

⁴⁶ TCI assumes that the current rules regarding notice to subscribers and local franchising authorities will apply to any rate increases permitted pursuant to the upgrade incentive form.

limited access to capital and delayed nationwide NII deployment. If the Commission is concerned about upgrade-related rate increases for basic service tiers, it can simply allow the cable operator to take the permitted upgrade increase on the cable programming services tier.⁴⁷

CONCLUSION

TCI respectfully urges the Commission to adopt the analysis and recommendations contained herein in its report to Congress on the competitive dynamics of the MVPD marketplace.

Respectfully submitted,
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⁴⁷ There is precedent for such an approach. In the Commission's "Going-Forward" order, it limited cable operators to taking the per channel adjustment only on cable programming services tiers. Going-Forward Order, 10 F.C.C.R. 1226, at ¶¶ 65, 70 (1994).

ATTACHMENT



UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Communications
and Information
Washington, D.C. 20230

January 12, 1995

Honorable Janet D. Steiger
Chairman
Federal Trade Commission
Sixth Street and Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Dear Chairman Steiger:

As head of the National Telecommunications and Information Administration, which serves as the President's advisor on telecommunications and information policy, I am writing to discuss cable "clustering," the process by which a cable company acquires one or more cable systems serving adjacent franchise areas. In April 1994, the Director of the Federal Trade Commission's ("FTC") Bureau of Competition was quoted as saying that clustering may raise competitive concerns. Based on that statement, and discussions with agency staff concerning certain cable acquisitions, the cable industry is concerned that the FTC may adopt a policy against cable clustering. The Administration believes that such an action by the FTC would disserve consumers and hinder the growth of competition in the telecommunications marketplace.

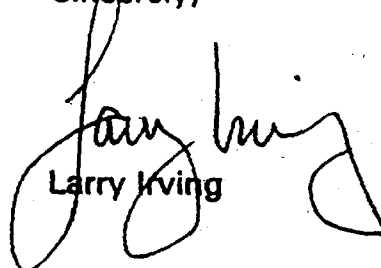
Cable clustering has at least two important benefits. First, owning systems in adjacent franchise areas can enable a cable firm to capture scale economies in the deployment of its distribution plant, thereby reducing the cost of providing cable service. As competition in the video marketplace continues to expand, a larger and larger proportion of those cost savings will be passed through to consumers in the form of lower rates. Second, cable companies are moving aggressively to enter the local telephone service market, and the Administration strongly supports such additional competition. Nevertheless, cable firms may not be able to offer local telephone services on a competitive basis unless, through clustering and other means, they can assemble service areas that approximate the areas served by the local telephone provider.

In contrast to the benefits of clustering, the potential competitive harms are largely conjectural, speculative, or de minimis. A cable operator's purchase of an adjacent system arguably reduces competition by eliminating a potential entrant into the acquiring system's franchise area. However, that argument rests on the untested and unproven assumption that adjacent cable operators are more likely to overbuild a particular cable system than non-adjacent operators. Further, some believe that clustering may raise cable rates, arguing that because subscribers

observe the rates charged by independently owned adjacent cable systems, such rates set an upper bound on the rates that subscribers are willing to pay to the cable system serving them. While that proposition is not implausible, it too is without empirical foundation.

In short, while the benefits of cable clustering are both probable and significant, the conceivable competitive harms are not. Consequently, the Administration urges the FTC to reevaluate its approach to the clustering issue. Please let me know if you would like to discuss this matter further.

Sincerely,

A handwritten signature in black ink, appearing to read "Larry Irving", written over the printed name.

Larry Irving

cc: Commissioner Mary L. Azcuenaga
Commissioner Roscoe B. Starek III
Commissioner Christine Varney